30

Office - Supreme Court, U.
JUN 3 1944
CHARLES ELMORE CROPL
CLERK

IN THE

Supreme Court of the United States

..... TERM 1944

No. 1078 127

BANKERS TRUST COMPANY, as Trustee, *et al.*,
Petitioners,

against

THE PEOPLE OF THE STATE OF NEW YORK,
Respondents.

PETITION OF BANKERS TRUST COMPANY, AS TRUSTEE, *ET AL.* FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

Dated June 2, 1944.

JESSE E. WAID,
WILLIAM ST. JOHN TOZER,
ELBERT N. OAKES,
WALTER H. BROWN,
WILBERFORCE SULLY, JR.,
Counsel for Petitioners.

INDEX

	PAGE
Petition for Writ of Certiorari	1
Summary Statement of Matters Involved	2
Facts	2
Jurisdiction of the Court	7
Specification of Error	7
Reasons for Application for the Writ	7

Brief

POINT I—No lien arose under New York law prior to the commencement of reorganization proceedings	9
POINT II—No lien could be acquired by the State after reorganization proceedings were instituted	9
POINT III—Section 67(b) of the Bankruptcy Act does not support the State's claim to a lien	11
POINT IV—The holding of the Circuit Court of Appeals that the claims are payable as taxes is erroneous	13
POINT V—A governmental preference is not involved	14

Table of Cases Cited

Central Savings Bank *v.* City of New York, 279 N. Y. 266 (December 6, 1938)	6, 13
Isaacs *v.* Hobbs Tie & T. Co., 282 U. S. 734 (1931)	10
Gross *v.* Irving Trust Co., 289 U. S. 342 (1933)	10

PAGE

Lockhart *v.* Garden City Bank & Trust Company, (C.C.A. 2d 1940, 116 F. (2) 658 10
Lowden *v.* Northwestern National Bank & Trust Co., 84 F. (2d) 847 (C.C.A. 8th, 1936), cert. den. 299 U. S. 583 (1936) 11
In re Chicago & N. W. Ry. Co., 18 F. Supp. 932 (N.D. Ill. 1936) 11
In re Kent Refining Co., 20 F. Supp. 661 (W.D. Mich. 1937) 11
City of New Orleans *v.* Harrell, 134 F. 2d 399 (C.C.A. 5th, 1943) 11
In re Columbia Tobacco Co., 121 F. (2d) 641 (C.C.A. 2d, 1941) 12

Table of Statutes Cited

Chapter 233 of the New York Laws of 1926 ..... 4, 9
Chapter 678 of the New York Laws of 1928 ..... 4, 5, 9
Section 77 of the Bankruptcy Act 2, 5, 7
Section 4 (3) of the New York Laws of 1928 8
Section 14 of Article VII of the New York Constitution 2
N. Y. Doc. 1926 Vol. 17, No. 94 pp. 8 and 9 3
Section 8297 of the Unconsolidated Laws (New York Laws of 1890, Chap. 565, Sec. 119 as amended) 9
Chandler Act of 1938 10
Section 67 (b) of the Bankruptcy Act 11
Chapters X, XI, XII, XIII of the Bankruptcy Act 12

Miscellaneous

Finletter, Law of Bankruptcy Reorganization (1939) pages 154 and 155 10
Finletter, Principles of Corporate Reorganization (1937) 161-162 11

IN THE

Supreme Court of the United States

..... TERM 1944

BANKERS TRUST COMPANY, as Trustee, *et al.*, *Petitioners,* *against* THE PEOPLE OF THE STATE OF NEW YORK, *Respondents.*	No.

PETITION FOR WRIT OF CERTIORARI

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The following Petitioners respectfully pray for a writ of certiorari to review a decree of the Circuit Court of Appeals for the Second Circuit entered on March 3, 1944, wherein so far as this Petition is concerned, that Court sustained an order dated June 2, 1943 made by the United States District Court for the Southern District of New York (in proceedings to reorganize the Debtor hereinafter mentioned under Section 77 of the Bankruptcy Act, as amended) (R. 5)* pursuant to its opinion filed February 19, 1943 (R. 73), which accorded to The People of the State of New York (herein called the "State") a lien in respect of its grade crossing elimination claims, but reserved for future determination the question whether the State's lien enjoyed priority over the preexisting mort-

*(R.) with a numeral indicates a page reference to the transcript of record in the Circuit Court of Appeals.

gages of New York, Ontario & Western Railway Company, Debtor (herein called the "Debtor"):

Bankers Trust Company, as Trustee under the Debtor's Refunding Mortgage dated June 1, 1892,
The New York Trust Company, as Trustee under the Debtor's General Mortgage dated May 31, 1905,
Frederick E. Lyford, Trustee of the Debtor in proceedings under §77 of the Bankruptcy Act.
Westmoreland Coal Company, a creditor under the "six-months' rule."

Summary Statement of Matters Involved

This petition involves the question whether as to grade crossing elimination claims arising under the New York statute which were not in default when the Debtor's petition for reorganization under Section 77 of the Bankruptcy Act was filed, the State could acquire a lien upon the mortgaged properties of the Debtor.

Facts

1. The Debtor's Refunding Mortgage is dated as of June 1, 1892 and secures an issue of $20,000,000 principal amount of Bonds presently outstanding (R. 60).

2. The Debtor's General Mortgage is dated as of May 31, 1905 and secures an issue of $12,000,000 principal amount of Bonds presently outstanding or pledged (R. 60).

3. At a general election held on November 3, 1925, Section 14 of Article VII of the State Constitution was approved, authorizing the Legislature to make provision for State aid in financing the elimination of grade crossings; and, at a general election held on November 8, 1927, an amendment thereto was approved (R. 88).

4. The Report of the Joint Legislative Committee of the New York Legislature, which had been appointed to investigate the grade crossing elimination problem, stated in part as follows:

> "The committee has been very much concerned with the question as to how the State would be assured of the repayment of moneys advanced in aid of the railroad companies under the provisions of the constitutional amendment.
>
> On January 19, 1925, the Chairman of the committee asked the Attorney General for an opinion on the following question: 'Has the Legislature the power to insure the repayment to the state of money advanced in aid of a railroad company under the provisions of the grade crossing constitutional amendment by making the state's claim a first lien upon the property of the railroad and collecting it in the form of a tax?'
>
> The Attorney General, in response to this question, furnished an opinion to the committee that the repayment of the moneys so advanced to the railroad companies could be made a first and paramount lien upon the property of the railroads.
>
> Such a provision was put in the first draft of the different grade crossing acts. The railroad companies then satisfied the committee that under the provisions of many of their mortgages this clause in the bills would make it impossible for them to avail themselves of state money without making these mortgages due within thirty days if the railroad companies permitted a lien to be put on their property ahead of these mortgages." (N. Y. Leg. Doc. 1926, Vol. 17, No. 94, at pp. 8 and 9).

5. Thereupon, the language of the bill was modified, and as so modified, the bill was enacted into law as Chapter 233 of the New York Laws of 1926, providing that 50 per centum of the cost of each elimination should be borne

by the railroad affected, and that upon application the State would advance the necessary funds to the railroad upon condition that repayment of such advances be made in instalments at such times and in such amounts as should be fixed by the Comptroller and set forth in a written statement to be served by him upon the railroad. Section 4 of Chapter 233 of the New York Laws of 1926 provided in part as follows:

> "*In the event of the failure or refusal* of the railroad corporation or of its successors or assigns *to pay* the amounts specified in such statement at the times therein prescribed, the amount or amounts so due and payable *shall be and become a first and paramount lien* upon all real property of said railroad within the municipal corporation within which the work is done." (Emphasis added.)

6. Chapter 678 of the New York Laws of 1928 repealed Chapter 233 of the New York Laws of 1926, as amended, and the requirements of certification, apportionment, assessment and levy were imposed in addition to default as conditions precedent to the existence of a lien to secure grade crossing elimination claims. The pertinent portions of Chapter 678, as amended, are contained in subdivision 3 of Section 4, which reads in part as follows:

> "The railroad corporation or corporations and the county or counties shall pay into the state treasury the amount or amounts specified in such statement at the times therein prescribed. * * * In the event of the failure or refusal of the railroad corporation or corporations, or the successor or successors thereof, to pay the amount or amounts specified in such statement at the times therein prescribed, * * * the amount or amounts so due and payable may be recovered as follows:

The comptroller may certify the amount or amounts so due and payable to the board of supervisors of the county or counties in which the crossing is located, whereupon, it shall be the duty of such board of supervisors to apportion the amount or amounts so certified to the several towns and cities in such county according to the assessed valuation of the real property of such railroad corporation or corporations or the successor or successors thereof in such respective towns and cities and to place the several amounts so apportioned on the respective assessment rolls of such towns and cities and to issue its warrant or warrants for the collection thereof. Thereupon it shall become the duty of such towns and cities through their proper officers to collect the respective several amounts so apportioned in the same manner as other taxes are collected in such towns and cities and when collected to pay the same to the county treasurer of such county who shall thereupon pay the same into the state treasury. *Any amount so levied shall thereupon become and be a first and paramount lien* upon all real property of such railroad corporation or corporations or the successor or successors thereof within such respective towns and cities." (Emphasis added.)

7. Pursuant to Chapter 678 of the Laws of 1928, as amended, the Public Service Commission of the State ordered the elimination of certain grade crossings. The Debtor elected to pay its share of the cost in installments of principal and interest over a period of fifty years. The Comptroller of the State determined the Debtor's share of the cost of the completed projects and fixed the amounts, terms and due dates of the fifty installment payments to be made by the Debtor (R. 58).

8. On May 20, 1937, the petition of the Debtor for reorganization under Section 77 of the Bankruptcy Act, as

amended, was approved as properly filed (R. 64). Previously, the Railway Company had not committed any default in making the installment payments as they became due (R. 65). The first default occurred in 1938 and all subsequently maturing instalments have been defaulted (R. 59).

9. On or about August 15, 1941, proof of claim was filed by the State for installments then in default (R. 16). On or about March 11, 1942, proof of claim was filed by the State for subsequently maturing installments which the State had purported to accelerate (R. 33). The Circuit Court of Appeals denied the existence of a right of acceleration.

10. Objections to said claims were filed by Petitioners; and, after a hearing, the District Court for the Southern District of New York held that said claims constituted liens against the Debtor's property, but reserved for future determination the question of priority of the State's lien.

11. Upon appeal, the Circuit Court of Appeals for the Second Circuit modified the decision of the District Court 1) by allowing a lien for the overdue installments, and 2) by denying to the State a right of acceleration. In its decision, the Circuit Court of Appeals made certain references to the claims having the status of taxes.

12. Petitioners applied to the Circuit Court of Appeals for a rehearing on the ground that the decision of that Court that the claims were payable as taxes, thereby indicating priority thereof over the Mortgages, was erroneous because contrary to the law of the State of New York, as enunciated in the case of *Central Savings Bank* v. *City of New York*, 279 N. Y. 266 (December 6, 1938). The Circuit Court of Appeals on May 9, 1944 denied the

motion. The Court stated that "The appeal did not adjudicate the issue reserved by the District Court, namely, 'determination as to priority of the State's lien.'" (Not yet reported).

Jurisdiction of the Court

This application is made under Section 240 of the Judicial Code, as amended (43 Stat. 938).

Specification of Error

The Circuit Court of Appeals has erred in holding that the claims of the State are liens.

Reasons for Application for the Writ

1. The question presented is one of general public interest.

2. The question of the extent to which statuory liens may be perfected subsequent to the filing of a debtor's petition under Section 77 of the Bankruptcy Act is a matter of importance in railroad reorganization proceedings generally. The decision of the Circuit Court of Appeals in this case raises a serious question of law with respect to the proper construction of Section 77 of the Bankruptcy Act and the applicability of Section 67(b) of the Act to railroad reorganization proceedings. The present state of the law on the broad question of the extent to which general bankruptcy provisions are to be deemed applicabe to railroad reorganization proceedings under Section 77 is not clear. As there has been no definitive adjudication by this Court, of the more precise issue here presented, or by any subordinate tribunal prior to the decision in this case, the granting of the petition for writ of certiorari will permit a clarification of the law. This point has particular importance in this case because prior to bankruptcy, under

subdivision 3 of Section 4 of Chapter 678 of the State Laws of 1928 as amended, a lien did not arise until after default, certification, apportionment, assessment and levy, none of which occurred until after the date of the filing of the Petition for Reorganization herein (R. 65).

WHEREFORE, Petitioners respectfully pray that a writ of certiorari issued to the United States Circuit Court of Appeals for the Second Circuit, commanding said Court to certify and send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in the case numbered on its docket 111, and that said decree of the United States Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that Petitioners may have such other and further relief in the premises as to this Honorable Court may seem just.

Dated June 2, 1944.

BANKERS TRUST COMPANY, as Trustee,
By JESSE E. WAID,
WILLIAM ST. JOHN TOZER,
Counsel.

THE NEW YORK TRUST COMPANY, as Trustee,
By WALTER H. BROWN,
Counsel.

FREDERIC E. LYFORD, Trustee,
By ELBERT N. OAKES,
Counsel.

WESTMORELAND COAL COMPANY,
By WILBERFORCE SULLY, JR.,
Counsel.

BRIEF IN SUPPORT OF THE FOREGOING PETITION

POINT I

No lien arose under New York law prior to the commencement of reorganization proceedings.

This conclusion is supported by:

(a) the Report of the Joint Legislative Committee (N. Y. Leg. Doc. 1926, Vol. 17, No. 94).

(b) the provision of Section 4 of Chapter 233 of the Laws of 1926, which conditioned the existence of a lien upon the event of the failure or refusal of the railroad corporation to pay the amounts due.

(c) the circumstance that in respect of street railroad companies, the Legislature accorded an immediate lien to take effect upon the railway company's election to pay in installments (Section 8297 of the Unconsolidated Laws, New York Laws of 1890, Chap. 565, Sec. 119, as amended).

(d) the provisions of Chapter 678 of the Laws of 1928, as amended, which impose the requirements of certification, apportionment, assessment and levy in addition to the requirement of default as conditions precedent to the existence of a lien.

POINT II

No lien could be acquired by the State after reorganization proceedings were instituted.

It is well settled that only valid liens existing at the time of the commencement of bankruptcy proceedings are

preserved. The general rule in bankruptcy is that the filing of the petition freezes the rights of all parties interested in the bankrupt estate; that upon adjudication of bankruptcy no lien may thereafter be created upon the property of the debtor, the title thereto having vested in the trustee as of the date of the filing of the petition. *Isaacs* v. *Hobbs Tie & T. Co.*, 282 U. S. 734 (1931); *Gross* v. *Irving Trust Co.*, 289 U. S. 342 (1933); *Lockhart* v. *Garden City Bank & Trust Company*, (C.C.A. 2d 1940), 116 F. (2) 658. The general rule is made applicable to Section 77 proceedings by Section 77(l) of the Bankruptcy Act which provides:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

The Chandler Act of 1938 expressly made the date of the filing of the petition the controlling date by providing in Section 70(a) that "The trustee of the estate * * * upon his * * * appointment and qualification, shall * * * be vested by operation of law with the title of the bankrupt as of the date of the * * * original petition * * *". Finletter, at pages 154 and 155 of his treatise, *Law of Bankruptcy Reorganization* (1939) states that this provision is applicable under Section 77. Before the Chandler Act codified the preexisting law in this respect Finletter said "Section 77(l) leaves no doubt but

that the date of the filing of the petition fixes the estate." *Principles of Corporate Reorganization* (1937), 161-162.

After title passes from the corporate debtor to the Trustee it is obviously impossible for a new claim to be acquired against the debtor or the debtor's property. It is therefore significant that "creditors" are defined in subdivision (b) of Section 77 as holders of claims "against the debtor or its property," not against the trustee or the property held by him.

This fixing of the estate on the date of filing the original petition, which in this case was May 20, 1937, is not inconsistent with any other provision of Section 77. Rights of creditors must be fixed on some certain date; and Congress has chosen the date of filing.

Lowden v. *Northwestern National Bank & Trust Co.*, 84 F. (2d) 847 (C.C.A. 8th, 1936), cert. den. 299 U. S. 583 (1936);

In re Chicago & N. W. Ry. Co., 18 F. Supp. 932 (N. D. Ill. 1936);

In re Kent Refining Co., 20 F. Supp. 661 (W. D. Mich. 1937);

City of New Orleans v. *Harrell*, 134 F. 2d 399 (C.C.A. 5th, 1943).

POINT III

Section 67(b) of the Bankruptcy Act does not support the State's claim to a lien.

The District Court properly sustained the objections to the State's claims insofar as they assert a right to a lien under Section 67(b) of the Bankruptcy Act. The Circuit

Court of Appeals erred in holding that Section 67(b) is applicable to Section 77 proceedings and that the State of New York is entitled to a lien upon the mortaged property of the Debtor. The grounds for refusing to recognize the establishment of a lien under that section are twofold and may be stated briefly as follows:

(1) The applicability of Section 67(b) is limited by its terms to proceedings in ordinary bankruptcy or those under Chapters X, XI, XII, or XIII of the Bankruptcy Act. The omission of any reference to Chapter VIII, of which Section 77 is a part, indicates that Section 67(b) is inapplicable to proceedings brought thereunder. Had Congress intended to make Section 67(b) applicable to Section 77 proceedings "it would have been very easy to say so." (*In re Columbia Tobacco Co.*, 121 F. (2d) 641 (C.C.A. 2d, 1941).) Thus, Section 53 of the Bankruptcy Act refers specifically not only to Chapters X, XI, XII and XIII, but also to Chapters VIII and IX, indicating that had Congress so intended in this instance it would have said so.

(2) Section 67(b) limits the class of statutory liens which may be perfected thereunder to those which "*arise* but are not perfected before bankruptcy." No lien arose prior to the commencement of these proceedings because no default occurred before the filing of the petition, a condition precedent to the creation of a lien under the New York statute. Under these circumstances it is clear that Section 67(b), even if applicable to Section 77 proceedings, does not permit the acquisition of a lien by the State of New York after the institution of reorganization proceedings.

POINT IV

The holding of the Circuit Court of Appeals that the claims are payable as taxes is erroneous.

Such holding of the Circuit Court of Appeals is erroneous because contrary to the Law of the State of New York as announced in the case of *Central Savings Bank* v. *City of New York*, 279 N. Y. 266 (December 6, 1938). The case cited indicates the law of New York to be that a charge upon real property is not a tax merely because it is labeled in the statute as an "assessment"; that a tax is a forced charge levied by the State upon persons or property; that it operates "in invitum" and is in no way dependent upon the will of contract, express or implied, of the persons taxed; that the Legislature cannot create a tax by calling it an assessment when it has not the elements or substance of a tax; and that the purported "assessment" involved in the case cited could not be a tax because the charges upon the real estate were optional with the owner (pp. 280 and 281).

So, with respect to the grade crossing elimination claims, the charges were similarly optional with the owner (the Debtor). Although the Debtor could not have ceased to operate (and in this respect is in a different position from the owner of a tenement house who could devote it to another use and thereby avoid the necessity of making the alterations and improvements directed by the Department of Housing and Buildings), yet the Debtor could have avoided certification, apportionment, assessment and levy, and avoided any debt to the State by borrowing the funds from someone other than the State, or by paying the charges as they accrued, out of its treasury. The Debtor

was under no obligation imposed by the statute to borrow from the State the funds necessary to pay the Debtor's share of the cost of eliminating the grade crossings. The New York Court of Appeals also stated that such an act constitutes a taking of property without due process of law and impairs the obligation of the contract with the mortgagor contrary to the provisions of the state and federal constitution (p. 275).

POINT V

A governmental preference is not involved.

The State acted only as a lender and not in a governmental capacity when it advanced the monies, therefore, it should not receive any preference usually granted to a government when acting in its sovereign capacity.

CONCLUSION

The writ of certiorari should be granted as prayed for.

Dated June 2, 1944.

Respectfully submitted,

JESSE E. WAID,
WILLIAM ST. JOHN TOZER,
WALTER H. BROWN,
ELBERT N. OAKES,
WILBERFORCE SULLY, JR.,
Counsel for Petitioners.

(31)

JUL 30 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1944

No. 127

BANKERS TRUST COMPANY, as Trustee, *et al.*,
Petitioners,

against

THE PEOPLE OF THE STATE OF NEW YORK,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York,
Attorney for Respondents,
80 Centre Street,
Borough of Manhattan,
City of New York.

ORRIN G. JUDD,
Solicitor General.
GERALD J. CAREY,
Assistant Attorney General,
of Counsel.

BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

INDEX.

	Page
Statement of the Case	1
Facts	2
The Opinions Below	4
Argument	6
POINT I.	
The State of New York has a valid lien against the Debtor's real property	6
State's Right to Create a Lien	8
POINT II.	
Section 77 of the Bankruptcy Act is intended to recognize the validity of existing liens	8
POINT III.	
The Circuit Court of Appeals was correct in its holding that the claims are payabye as taxes	11
POINT IV.	
A Governmental preference is involved	13
Conclusion	14

CASES CITED.

Board of Directors, St. Francis Levee District v. Kurn, 98 F. (2d) 394, cert. den., 305 U. S. 647	11
Boteler v. Ingels, 308 U. S. 57	10
Central Savings Bank v. City of New York, 279 N. Y. 266	11, 12, 13
City of New York v. Rassner, 127 F. (2d) 703	10
Denver & Rio Grande R. Co. v. Denver, 250 U. S. 241	8
Erie Railroad v. Board of Public Utilities Comm., 254 U. S. 394	8
In re Chicago, Milwaukee, St. P. & P. Ry. Co., 27 F. Supp. 685	9

Page

In re Erie Railroad Co., 37 F. Supp. 237 11
In re Fonda, Johnstown & Gloversville Ry. Co., 126 F. (2d) 604; cert. den. *sub. nom.* Zimmer v. New York State Tax Commission, 316 U. S. 701 9
In re Otto F. Lange Co., 159 Fed. 586 13
In re Mid America Co., 31 F. Supp. 601 13
In re Missouri Pacific Ry. Co., 113 F. (2d) 794 7
Lyford v. City of New York, 137 F. (2d) 782 10
Marshall v. New York, 254 U. S. 380 8
Matter of Carnegie Trust Co., 151 App. Div. 606, aff'd, 206 N. Y. 390 8
Matter of New York, Ontario & Western Ry. Co., 244 App. Div. 664, aff'd, 271 N. Y. 567 .....8, 11, 12
Matter of Staten Island R. T. Ry. Co., 220 App. Div. 80, aff'd, 245 N. Y. 643 8
Missouri K. & T. R. Co. v. Oklahoma, 271 U. S. 303 8
Missouri, Pacific Ry. Co. v. Omaha, 235 U. S. 121 8
New York Terminal Co. v. Gaus, 204 N. Y. 512 8
New York Trust Co. v. Palmer, 101 F. (2d) 1 10
Palmer v. Webster Atlas National Bank, 312 U. S. 156 9
Panhandle Eastern Pipe Line Co. v. State Highway Comm., 294 U. S. 613 13
Thompson v. Glover, 94 F. (2d) 544 .....10, 11
Thompson v. Louisiana, 98 F. (2d) 108 9
Van Schaick v. McCarthy, 116 F. (2d) 987 9

STATUTES.

Act of June 2, 1934 (C. 585, 58 Stat., 993, 28 U.S.C.A. Sec. 124a) 5, 9
New York Laws 1926, c. 233 2
New York Laws 1928, c. 678 (McKinney's Unconsolidated Laws, Sec. 7901-12) 2, 3, 4, 6, 10, 11, 12
New York State Constitution, Art. VII, Sec. 14 2
U. S. Bankruptcy Act, Sec. 67-B 5, 9, 10
U. S. Bankruptcy Act, Sec. 77 .....5, 8, 9, 10

IN THE

Supreme Court of the United States

October Term, 1944

No. 127

BANKERS TRUST COMPANY, as Trustee, *et al.*,
Petitioners,
against
THE PEOPLE OF THE STATE OF NEW YORK,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Statement

The petitioners pray for a writ of certiorari to review a decree of the Circuit Court of Appeals for the Second Circuit entered on March 3, 1944, which decree in part sustained an order dated June 2, 1943 made by the United States District Court for the Southern District of New York (R. 5).

Pursuant to the opinion of the Circuit Court of Appeals it was determined that the State of New York (hereinafter called the State) had a valid lien against the real property of the New York, Ontario and Western Railway Company,

Debtor (hereinafter called the Debtor) for the amounts due on past due installments of a grade crossing elimination debt (R. 100), and there was reserved for future determination the question of the priority of the State's lien over pre-existing mortgages of the Debtor.

Facts

The petition sets forth only a portion of the facts on which the Circuit Court's determination was based.

I. The Debtor operated a railroad extending from Weehawken, New Jersey to Oswego, New York. The portion of the Debtor's railroad within the State of New York was operated under a franchise from the Legislature of the State of New York (R. 57-58).

II. By authority of a 1925 amendment of the Constitution of the State of New York (Art. VII, Sec. 14) the Legislature adopted what is known as the Grade Crossing Elimination Act (L. 1926, c. 233, superseded by L. 1928, c. 678; McKinney's Unconsolidated Laws, Sec. 7901-12). Pursuant thereto the Debtor, in common with other railroads, was required to eliminate certain grade crossings and to pay fifty percent of the cost of the elimination (Unconsolidated Laws, Sec. 7903).

The Act further provided that if the Railroad so elected the State would pay the Railroad's share of the cost of the elimination in the first instance, and the Railroad would then be obliged to pay the State in a manner to be determined by the State Comptroller, so that the principal and interest on the State's debt, incurred for such elimination, might be paid when due (Unconsolidated Laws, Sec. 7904 (1, 2)).

III. The orders requiring the grade crossing eliminations involved in these claims were made by the Public Service Commission of the State of New York, after public hearings held to determine whether the public welfare required the elimination of each of the crossings (R. 62). Due notice of these hearings was given by service on the Debtor and by publication in a newspaper published in the county wherein the proposed elimination was located (R. 62-64). The Grade Crossing Elimination Act further provided that any person aggrieved by an order of the Public Service Commission could appeal to the Appellate Division of the Supreme Court of the State of New York and to the Court of Appeals (Unconsolidated Laws, Sec. 7910).

IV. The Debtor herein elected in writing to have the State pay its share of the cost of the eliminations in the first instance, and repayment was directed to be made in installments over a period of fifty years (R. 58-59). The Debtor likewise consented in writing to the State Comptroller's determination of the railroad's share of the cost of the elimination. The last of these consents was filed on January 2, 1936 (R. 175), which was prior to the date of the filing of the petition for reorganization on May 20, 1937.

V. No default occurred in the payment of any installment prior to the filing of the Debtor's petition for reorganization. By a petition dated June 22, 1937 the Debtor prayed for permission to continue the payments on said installments as they accrued, and an order was made by the District Court on June 28, 1937 granting such permission (R. 59). Pursuant thereto the Debtor paid all installments due for the year 1937. Beginning in 1938 the Debtor defaulted in the payment of the installments, and continues in default.

The Comptroller of the State of New York duly certified to the Boards of Supervisors of the various counties, wherein the grade crossing eliminations had been carried out, that the Debtor was in default in the payment of the various installments of principal and interest (R. 18-32). Before the Boards of Supervisors could assess and apportion the tax as provided for in the Grade Crossing Elimination Act (Unconsolidated Laws, Sec. 7904 (3)), the petitioners obtained an order from the District Court restraining the Boards of Supervisors from so doing. Thereafter, the District Court lifted the injunction to the extent that leave was granted to the State to assess and apportion its liens. After the assessment and apportionment of the liens by the Boards of Supervisors the proofs of claim were filed herein (R. 80). The claim of August 15, 1941 is for the installments due for the years 1938 and 1939 (which claim the Circuit Court has allowed), and the claim dated March 11, 1942 is for the balance of the principal due on the Debtor's share of the cost of the elimination (which claim the Circuit Court has disallowed upon the ground that there could be no acceleration of the payments unless there was a dissolution of the Debtor, but granted the State leave to assess its lien for all past due installments not included in the claim of August 15, 1941) (R. 102).

The Opinions Below

The case involves two primary questions, of which the first relates to the nature of the lien conferred by New York law. The second, as to the interpretation of the Federal Bankruptcy Act, is important only if it is held that there was no lien under State law at the date the reorganization proceeding began.

On the question of New York Law the District Court, sitting in New York, held that the State obtained a lien at

the latest on the date when it made its advances for the expense of the grade crossing eliminations (R. 85), and it refused to sanction a result which would entitle the purchaser at a foreclosure sale to "take over the railroad with grade crossing eliminations made at the State's expense without any repayment to the State therefor" (R. 86). On the Federal question, it held that section 67b of the Bankruptcy Act (providing that liens for debts owing to a State are valid against a trustee) was not applicable to Chapter VIII of the Bankruptcy Act, which included section 77, governing the reorganization of railroads (R. 78n, 79), but it pointed out that in any event section 77 requires a trustee to take property subject to existing liens (R. 80).

The determination as to the priority of the State's lien was reserved for future consideration (R. 86).

The Circuit Court of Appeals, on appeal by the objectors, again determined the question of State law in favor of the State, with a slight modification. It held that the question "turns upon the intent of the New York Legislature." After analysis of various New York cases, it held that the statute gave the State a lien for the installments as they came due, which would be good against a state receivership or other insolvency proceeding (the modification, from which the State has not appealed, denied the State's right under the New York statute to accelerate future installments for defaults during reorganization).

On the question of recognition of the State lien in a Federal Bankruptcy proceeding, the Circuit Court held that, even if section 67b did not apply, the lien should be given the same recognition in a railroad reorganization that it would have received in receivership. It also pointed out that the State's claim had at least the status of taxes, which it was the duty of the trustee to pay as expenses of administration (28 U. S. C. A. §124a).

ARGUMENT

POINT I

The State of New York has a valid lien against the debtor's real property.

The entire argument in petitioners' brief depends on the validity of Point I of their brief, in which they assert that no lien arose under New York law prior to the commencement of reorganization proceedings.

This question of the interpretation of the New York statute has been decided contrary to petitioners' contentions by a District Judge, resident in New York and sitting in New York, and by a Circuit Court of Appeals sitting in New York. Normally this Court will not review the concurrent determinations of lower Federal Courts on questions of State law.

As this Court said in *MacGregor* v. *State Mutual Life Assur. Co.*, 315 U. S. 280, 281, "We should leave undisturbed the interpretation placed upon purely local law by a Michigan federal judge of long experience and by three circuit judges whose circuit includes Michigan." See also, *Reitz* v. *Mealey*, 314 U. S. 33; *Helvering* v. *Stuart*, 317 U. S. 154.

Upon completion of the grade crossing elimination the Railroad became liable for one-half of the cost thereof (Unconsolidated Laws, Sec. 7903). Upon the Debtor's election to pay in installments the real property of the Debtor became subject to the statutory lien the State had created to secure the moneys due it (Unconsolidated Laws, Sec. 7904 (3)).

The fact that the State is given an immediate lien for amounts advanced in aid of railroad companies was estab-

lished by an opinion of the New York Attorney General shortly after the passage of the 1926 Grade Crossing Elimination Act (1927 Rep. Atty. Gen. 262). The committee report upon which the petitioners rely (Petition, p. 3) for a different construction of the New York statute was not filed until after the bill had become law, and is therefore not decisive of the legislative intent; its bearing upon the nature of the State's lien was undoubtedly considered by the Attorney-General in giving his opinion in 1927. This administrative determination, uniformly followed for over fifteen years, and acted on in other railroad reorganizations, fixed the meaning of the statute, under familiar doctrines of construction.

Martorano v. *Capitol Finance Corporation*, 289 N. Y. 21;

People ex rel. Werner v. *Prendergast*, 206 N. Y. 405, 411;

Matter of City of New York (Willard Parker Hospital), 217 N. Y. 1, 12-13;

1 McKinney's New York Consolidated Laws, §§ 128, 129.

All of the eliminations involved in the proofs of claim herein were completed prior to the petition for reorganization, dated May 20, 1937, so that the Debtor was indebted to the State for the amount allowed by the Court below, prior to the proceedings in the Bankruptcy Court. Such debt was secured by a lien provided for by statute, and the Court took control of the Debtor's property subject to this lien of the State.

In re Missouri Pacific Ry. Co., 113 F. (2d) 794 (C. C. A. 8th).

STATE'S RIGHT TO CREATE A LIEN

The right of the State to create a lien for debts due it stems from the prerogative right at common law, which gave the British Crown a priority over all subjects for payment out of a debtor's property for all debts due it.

Matter of Carnegie Trust Co., 151 App. Div. 606, aff'd, 206 N. Y. 390;
Marshall v. *New York*, 254 U. S. 380;
New York Terminal Co. v. *Gaus*, 204 N. Y. 512.

The lien herein secured a debt due for a governmental purpose, for statutes requiring the elimination of grade crossings are an exercise of the police power of the State.

Matter of Staten Island Rapid Transit R. Co., 220 App. Div. 80, aff'd, 245 N. Y. 643;
Erie Railroad v. *The Board of Public Utilities Comm.*, 254 U. S. 394;
Matter of New York, Ontario & Western Ry. Co., 244 App. Div. 644, aff'd, 271 N. Y. 567;
Denver & Rio Grande R. Co. v. *Denver*, 250 U. S. 241;
Missouri K. & T. R. Co. v. *Oklahoma*, 271 U. S. 303;
Missouri Pacific Ry. Co. v. *Omaha*, 235 U. S. 121.

POINT II

Section 77 of the Bankruptcy Act is intended to recognize the validity of existing liens.

The petitioners herein argue for a narrow construction of Section 77 of the Bankruptcy Act, urging that there having been no default in the payment of the installments prior to the filing of the petition for reorganization, the State is estopped from asserting its lien when there is a

subsequent default by the Debtor in its payments. Such a construction is contrary to the purposes for which Section 77 was enacted. Section 77 has for its main purpose the rehabilitation, and to that extent contemplates the corporate existence, of the Debtor.

Thompson v. *Louisiana*, 98 F. (2d) 108, 110 (C. C. A. 8th).

Van Schaick v. *McCarthy*, 116 F. (2d) 987, 993 (C. C. A. 10th).

The Act of June 2, 1934 (C. 585, 58 Stat. 993, 28 U. S. C. A. Sec. 124 a) imposed a duty on the Trustee of the Debtor to pay the installments as they became due,

Palmer v. *Webster Atlas National Bank*, 312 U. S. 156;

In Re Fonda, Johnstown & Gloversville Ry. Co., 126 F. (2d) 604; cert. den. *sub. nom. Zimmer* v. *New York State Tax Comm.*, 316 U. S. 701;

and upon the failure of the Trustee so to pay, the State was entitled to assess its lien.

The power of the Court to permit the assessment and apportionment of the lien was derived from subdivision (b) of Section 77 as well as from Section 67b of the Bankruptcy Act.

Subdivision (b) of Section 77 provides that the term "creditors" shall include all holders of claims, whether or not such claims would constitute provable claims under the Act, and "claims" is defined as including liens. The courts have interpreted this provision to permit the filing of claims that would necessarily have been barred under the strict interpretation of the Act urged by the petitioner.

In re Chicago, Milwaukee, St. P. & P. Ry. Co., 27 F. Supp. 685 (N. D. Ill.);

New York Trust Co. v. *Palmer*, 101 F. (2d) 1 (C. C. A. 2d);
Lyford v. *City of New York*, 137 F. (2d) 782 (C. C. A. 2d);
Thompson v. *Glover*, 94 F. (2d) 544 (C. C. A. 8th);
Boteler v. *Ingels*, 308 U. S. 57;
City of New York v. *Rassner*, 127 F. (2d) 703 (C. C. A. 2d).

In addition to the broad powers conferred on the Court by subdivision (b) of Section 77, Section 67-b of the Bankruptcy Act specifically permits the State to perfect its lien despite the fact the mechanics of the assessing and apportioning the lien had not been completed prior to the filing of the petition for reorganization.

As the New York statute was construed below, the debt having been incurred by the Railroad prior to the filing of the petition, its payment was at all times secured by a lien on the real property of the Debtor. Upon default in payment all that remained for the State to do was to assess and apportion its lien (Unconsolidated Laws, Sec. 7904 (3)).

The very purpose of the enactment of Section 67-b of the Bankruptcy Act was to protect the United States Government and the various States in the exact situation presented herein. While it is true that Section 77 is not referred to specifically in Section 67-b of the Bankruptcy Act, nevertheless the provisions of the Bankruptcy Act should be applied to a proceeding under Section 77 unless the provisions of the Bankruptcy Act are inconsistent with the provisions of Section 77.

Lyford v. *City of New York*, *supra*;
New York Trust Co. v. *Palmer*, *supra*;

Board of Directors, St. Francis Levee District v. *Kurn*, 98 F. (2d) 394 (C. C. A. 8th), cert. den., 305 U. S. 647;
Thompson v. *Glover, supra;*
In re. Erie R. Co., 37 F. Supp. 237 (N. D. Ohio).

POINT III

The Circuit Court of Appeals was correct in its holding that the claims are payable as taxes.

There is no basis for petitioners' assertion that the decision of the Circuit Court of Appeals herein was contrary to the law of New York as announced in the case of *Central Savings Bank* v. *City of New York*, 279 N. Y. 266. The charge imposed under the statute therein was held not to be a tax solely because it was optional with the owner whether he accepted it or not (p. 280).

In the instant appeal the assessment for the Railroad's share of the cost of the elimination meets all the requirements of a tax as defined by the Court of Appeals in the *Central Savings Bank* case:

> "A tax is a forced charge levied by the State upon persons or property. It operates *in invitum* and is in no way dependent upon the will or contract, expressed or implied, of the persons taxed. (City of Rochester v. Bloss, 183 N. Y. 42, 47, 48; City of New York v. McLean, 170 N. Y. 374)". (p. 280.)

The acceptance of the charge for the cost of the grade crossing elimination involved in this appeal was in no way optional with the Debtor. One-half of the cost of the elimination was imposed on the Railroad irrespective of the desires of the Railroad (Unconsolidated Laws, Sec. 7903).

Matter of New York, Ontario & Western R. Co., 244 App. Div. 664, aff'd, 271 N. Y. 567.

The only option afforded the Railroad under the statute was the privilege of paying its share in installments, if it so desired. This privilege in no way altered its nature as a forced charge levied by the State, for the Railroad was at all times obligated to pay one-half of the cost, irrespective of which manner of payment it elected to use.

The Grade Crossing Elimination Act further provided that in the event of a default it became the duty of the towns and cities to collect the moneys in the same manner as other taxes are collected in such towns and cities (Unconsolidated Laws, Sec. 7904 (3)).

The constitutional objections in the *Central Savings Bank* case were based on the failure to afford a proper hearing to property owners, and the use of the money collected for a private purpose; neither factor is present in this case.

Under the Grade Crossing Elimination Act the Public Service Commission could order a crossing eliminated only after a public hearing on due notice to all interested parties, and subject to review by the Appellate Division and the Court of Appeals (Unconsolidated Laws, Sec. 7902 (5), 7910).

The Debtor did appeal from the order of the Public Service Commission for one of the eliminations involved in this claim, and the Court of Appeals upheld the constitutionality of the statute *(Matter of New York, Ontario and Western R. Co., supra)*.

As to the purpose for which the moneys were to be used, one of the cases relied upon by the Court of Appeals

in the *Central Savings Bank* case was the decision of this Court in

> *Panhandle Eastern Pipe Line Co.* v. *State Highway Comm.*, 294 U. S. 613.

This latter case emphasized the fact that grade crossing elimination statutes are one of the highest possible uses of the police power for a public purpose (294 U. S. at 620-22).

POINT IV

A governmental preference is involved.

Irrespective of whether the moneys due from the Debtor to the State are labeled a tax or simply a debt, the State is still entitled to its governmental preference. The Courts have held that senior position should be given to any charge which is imposed by a State in connection with a public improvement necessitated by the exercise of the police power of the State.

> *In re Mid America Co.*, 31 F. Supp. 601, 603 (S. D. Ill.);
>
> *In re Otto F. Lange Co.*, 159 Fed. 586 (N. D. Iowa).

CONCLUSION

We respectfully submit that this cause presents no question warranting review by this Court, and urge that the petition be denied.

Dated: July 6, 1944.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York,
Attorney for Respondents,
Office & P. O. Address,
80 Centre Street,
Borough of Manhattan,
City of New York.

ORRIN G. JUDD,
Solicitor General.
GERALD J. CAREY,
Assistant Attorney General,
of Counsel.